FILE COPY

FILED
MAY 29 1958
JAMES R. BROWNING, C

No. 883

In the Supreme Court of the United States

OCTOBER TERM, 1958

EMBRY BROTHERS, INC., and JAMES DRURY,
PETITIONERS

v.

HOWARD L. DAVIS, CITIZENS FIDELITY BANK & TRUST COMPANY, and UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR THE UNITED STATES IN OPPOSITION

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General,

A. F. PRESCOTT,
MELVIN L. LEBOW,
Attorneys,
Department of Justice,
Washington 25, D. C.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Argument	4
Conclusion	8
Appendix	9

CITATIONS

Cases:

Belknap Hardware & Mfg. Co. v. *Ohio River C. Co.*, 271 Fed. 144	6
Hoefflin v. *Wilkerson*, 184 Ky. 484	7
Hopkins v. *Eureka Coal Co.*, decided February 25, 1944 (C.C. Kanawha Co., W.Va.)	8
New York v. *Maclay*, 288 U.S. 290	6
Spokane County v. *United States*, 279 U.S. 80	8
United States v. *Colotta*, 350 U.S. 808, reversing 79 So. 2d 474	5
United States v. *Hulley*, 358 U.S. 66, reversing 102 So. 2d 599	6
United States v. *Kings County Iron Works*, 224 F. 2d 232	5
United States v. *Morrison*, 247 F. 2d 285	6
United States v. *New Britain*, 347 U.S. 81	5, 7
United States v. *Scovil*, 348 U.S. 218	5
United States v. *Security Tr. & Sav. Bk.*, 340 U.S. 47	5, 6
United States v. *Vorreiter*, 355 U.S. 15, reversing 134 Colo. 548	5
United States v. *White Bear Brewing Co.*, 350 U.S. 1010, rehearing denied, 351 U.S. 958, reversing 227 F. 2d 359	5

Statutes:

	Page
Act of August 24, 1935, c. 642, 49 Stat. 793:	
Sec. 1 (a) (40 U.S.C. 270a)	2, 5, 10
Sec. 2 (a) (40 U.S.C. 270b)	2, 5, 10-11
Sec. 2 (b) (40 U.S.C. 270b)	2, 5, 11-12
Internal Revenue Code of 1939:	
Sec. 3670 (26 U.S.C. 3670)	2, 9
Sec. 3671 (26 U.S.C. 3671)	2, 9
Sec. 3672(a) (26 U.S.C. 3672(a))	2, 5, 9

Miscellaneous:

1 Restatement of the Law of Contracts, Sec. 346	7

In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 883

EMBRY BROTHERS, INC., and JAMES DRURY, PETITIONERS

v.

HOWARD L. DAVIS, CITIZENS FIDELITY BANK & TRUST COMPANY, and UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 23a-29a) are not officially reported. The order of the Court of Appeals, affirming the judgment of the District Court, is reported at 260 F. 2d 356.

JURISDICTION

The judgment of the Court of Appeals was entered on October 10, 1958, and a petition for rehear-

ing was denied on February 4, 1959. (Pet. 13.) The petition for a writ of certiorari was filed on May 1, 1959. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether United States liens for unpaid taxes owed by a subconstractor are entitled to priority, over the adverse claims of lessors of trucks used by the subcontractor in performing his contract, in a fund paid by the prime contractor in settlement of a suit for breach of contract.

STATUTES INVOLVED

Sections 3670, 3671 and 3672(a) of the Internal Revenue Code of 1939 and Sections 1 (a)(2) and 2 (a) and (b) of the Act of August 24, 1935 are set forth in the Appendix, *infra*, pp. 9-12.

STATEMENT

On February 16, 1952, Howard L. Davis (hereinafter called the taxpayer or the taxpayer-subcontractor) executed a subcontract, for construction work on a United States Army installation in Kentucky, with J. W. Bateson Company, Inc. (hereinafter called Bateson). On October 8, 1952, Bateson terminated the contract and the taxpayer, individually, filed this action in the District Court against Bateson for damages for breach of the contract. (R. 23a.)

On July 31, 1956, the taxpayer and Bateson effected a compromise under which Bateson paid into the District Court $20,000 (hereinafter called the

fund), to be distributed in accordance with further orders of the court. Certain assignees, asserted lienholders, and creditors of the taxpayer claimed interests in the fund, and Bateson interpleaded, among others, the Citizens Fidelity Bank & Trust Company (hereinafter called the Bank or Citizens Fidelity), the United States, and Embry Brothers, Inc., each of whom claimed an interest in the fund. (R. 23a.)

On January 23, 1953, the taxpayer, in consideration of the Bank's forbearing to institute litigation against him to recover the unpaid balance of $8,554.44 and interest on his past due note made to the order of the Bank, had signed, executed and delivered to the Bank a written assignment conveying to it all of his right, title and interest in and to the first $9,000 to be recovered by him out of the proceeds of his recovery in the present action. On February 10, 1953, the Bank had notified Bateson Company of the assignment. (R. 23a-24a.)

On July 2, 1952, Embry Brothers, Inc., had leased to the taxpayer-subcontractor certain equipment. The taxpayer thereafter defaulted on the lease and abandoned the equipment, which was repossessed by Embry Brothers, Inc. That corporation asserts an equitable lien on the fund in the amount of $1,128.80, with interest from October 26, 1952. James Drury asserts a claim in the amount of $725, and interest thereon from April 6, 1952, which claim arises from similar facts. (R. 25a-26a.)

On March 2, 1953, and in August and September of that year the United States assessed withholding

and excise taxes against the taxpayer in the total amount of $12,044.32. The United States claims that amount, with interest, out of the fund under the provisions of Sections 3670, 3671 and 3672(a) of the Internal Revenue Code of 1939. (R. 25a.)

On or about December 6, 1956, the District Court found that counsel for the taxpayer was entitled to $6,666.66 to be paid out of the fund. This finding is not contested, and it reduces the amount of the fund in question to $13,333.34. (R. 26a.)

On August 16, 1957, the District Court held that the relative priorities of the various claims to the fund are as follows (R. 29a): First that Citizens Fidelity by virtue of the assignment dated January 23, 1953, has a lien that is prior and superior to the tax liens of the United States; secondly, that the tax liens of the United States are superior to the claims of Embry Brothers, Inc., and James Drury; and thirdly, that Embry Brothers, Inc., and James Drury have no lien on the funds in court. The Court of Appeals, by an order entered October 10, 1958, affirmed the judgment of the District Court. (Pet. 13.) Petition for rehearing was denied February 4, 1959. (Pet. 13.)

ARGUMENT

1. The fund interpleaded represents an amount paid in compromise of taxpayer's suit against the prime contractor for breach of contract. After awarding others priority in the $20,000 interpleaded, the court rendered judgment to the United States upon its tax claims for the balance—$4,333.34. A federal tax lien in excess of this amount arose on

March 2, 1953[1] (R. 25a), and attached on that date to the taxpayer's right of action against the prime contractor. *United States* v. *Kings County Iron Works*, 224 F. 2d 232 (C.A. 2). While such a tax lien is not valid against mortgagees, pledgees, purchasers and judgment creditors unless proper notice is filed (Section 3672(a), Internal Revenue Code of 1939 (Appendix, *infra*, p. 9)), as to all other claimants the tax lien is perfected on the date it arises, and Section 3672 affords no protection. *United States* v. *Scovil*, 348 U.S. 218; *United States* v. *Security Tr. & Sav. Bk.*, 340 U.S. 47, 51 (concurring opinion). The doctrine of first in time, first in right, applies only to specific and perfected liens and has no application where a federal tax lien, which is perfected on the date it arises, and an adverse inchoate lien are involved. *United States* v. *New Britain*, 347 U.S. 81. A mechanic's lien is an inchoate lien up to the time that the necessary steps have been taken to perfect it. *United States* v. *Vorreiter*, 355 U.S. 15, reversing 134 Colo. 543; *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010, rehearing denied, 351 U.S. 958, reversing 227 F. 2d 359 (C.A. 7); *United States* v. *Colotta*, 350 U.S. 808, reversing 79 So. 2d 474 (Miss.).

Indeed, here petitioners do not even stand upon an inchoate mechanic's lien. Their claims are based upon Sections 1(a) and 2(a) and (b) of the Act of August 24, 1935 (Appendix, *infra*, pp. 10-12), otherwise known as the Miller Act. That Act gives an un-

[1] Other tax liens arose in August and September, 1953. (R. 25a.)

paid materialman who supplies material for construction on Government property a right of action against the surety on the payment bond supplied by the contractor. The courts below correctly held (R. 28a-29a) that the Miller Act does not create liens, and that petitioners are but general creditors of the taxpayer with no lien upon the funds in court.[2]

Petitioners' assertion that they hold equitable liens which relate back to accord them priority over the federal tax liens is without merit. The doctrine of relation does not apply against the United States. *New York* v. *Maclay*, 288 U.S. 290; *United States* v. *Security Tr. & Sav. Bk., supra; United States* v. *Hulley*, 358 U.S. 66, reversing 102 So. 2d 599 (Fla.).[3] And see *United States* v. *Morrison*, 247 F. 2d 285 (C.A. 5), wherein the court states (p. 289) in reference to a vendor's lien:

> * * * while once established by judgment under the doctrine of relation back, it has a high order in the state hierarchy, until the act of judgment

---

[2] Although some of the cases cited by the petitioners (Pet. 9) hold that in equity materialmen may have a preference over other *general creditors*, none holds that they take priority over other lienors expressly recognized as such under statutory enactments or at common law. See, for example, *Belknap Hardware & Mfg. Co.* v. *Ohio River C. Co.*, 271 Fed. 144 (C.A. 6). Indeed, that case, which is one upon which the petitioners rely (Pet. 9), was decided by the same court which decided the instant case.

[3] It is to be noted that the District Court here held that taxpayer's assignment to the bank related back. This, we submit, was error. What occurred was an assignment by taxpayer to the bank *pro tanto* of his existing right of action against the prime contractor.

occurs, it is, in the Federal view, as contingent as any other lawsuit.

2. Nor is there merit to the petitioners' contention, raised for the first time in petition for rehearing, that the decisions below divert funds due to be paid jointly to the taxpayer and petitioners.[4] The fund involved represents payment in compromise of taxpayer's suit against the prime contractor for breach of contract. The measure of damages in such a case is the amount of profits lost, or *quantum meruit*, the option being with the plaintiff. 1 Restatement of the Law of Contracts, Sec. 346; *Hoefflin* v. *Wilkerson*, 184 Ky. 484. It is clear that the provision in the contract for joint payment to materialmen "for all materials furnished" does not apply in favor of the petitioners who merely rented trucks to the taxpayer. In any event, as previously discussed, the fund in question was not paid pursuant to the contract, but was paid for the injury resulting to the taxpayer from the prime contractor's termination of the subcontract.

3. Even if it be determined, as petitioners contend, that they have a claim superior to that of the Citizens Fidelity Bank & Trust Company, whose claim has been held to be superior to the federal tax liens, no reduction would follow in the amount distributable to the United States. *United States* v. *New Britain*, *supra*. The so-called "circuity of liens" rule would apply. The United States would be entitled to receive

---

[4] The provision of the contract to which petitioners evidently refer is found for the first time in the printed record in an appendix printed to their petition for rehearing.

first payment from the fund after an amount sufficient to pay the bank's claim had been set aside; and the petitioners would have to look for payment to the amount set aside for the bank. See *Spokane County* v. *United States*, 279 U.S. 80, 91; *Hopkins* v. *Eureka Coal Co.* (C.C. Kanawha Co., W.Va.), decided February 25, 1944 (33 A.F.T.R. 1627).

CONCLUSION

The decision below is correct. There is no conflict. The petition for certiorari insofar as it involves the federal tax claims should be denied.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

A. F. PRESCOTT,
MELVIN L. LEBOW,
Attorneys.

MAY, 1959.

APPENDIX

Internal Revenue Code of 1939:

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 3670.)

SEC. 3671. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 3671.)

SEC. 3672 [As amended by Sec. 401, Revenue Act of 1939, c. 247, 53 Stat. 862]. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*— Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(26 U.S.C. 3672.)

Act of August 24, 1935, c. 642, 49 Stat. 793:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) before any contract, exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

* * * * *

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than $1,000,000 the said payment bond shall be in a sum of one-half the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $1,000,000 and not more than $5,000,000, the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $5,000,000 the said payment bond shall be in the sum of $2,500,000.

* * * * *

(40 U.S.C. 270a.)

SEC. 2. (a) Every person who has furnished labor or material in the prosecution of the work

provided for in such contract, in respect of which a payment bond is furnished under this Act and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him: *Provided, however*, That any person having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor furnishing said payment bond shall have a right of action upon the said payment bond upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. Such notice shall be served by mailing the same by registered mail, postage prepaid, in an envelop addressed to the contractor at any place he maintains an office or conducts his business, or his residence, or in any manner in which the United States marshal of the district in which the public improvement is situated is authorized by law to serve summons.

(b) Every suit instituted under this section shall be brought in the name of the United States

for the use of the person suing, in the United States District Court for any district in which the contract was to be performed and executed and not elsewhere, irrespective of the amount in controversy in such suit, but no such suit shall be commenced after the expiration of one year after the date of final settlement of such contract. The United States shall not be liable for the payment of any costs or expenses of any such suit.

(40 U.S.C. 270b.)

☆ U. S. GOVERNMENT PRINTING OFFICE: 1959 507705 - 1526